(17)

No. 95-860

In The

Supreme Court of the United States

October Term, 1995

BARBARA SMILEY,

Petitioner,

v.

CITIBANK (SOUTH DAKOTA), N.A.,

Respondent.

On Writ Of Certiorari To The California Supreme Court

REPLY BRIEF FOR PETITIONER

PATRICK J. GRANNAN
ROBIN B. HOWALD
CHIMICLES, JACOBSEN & TIKELLIS
633 West Fifth Street
Los Angeles, CA 90071
(213) 623-8100

MICHAEL P. MALAKOFF
MALAKOFF, DOYLE & FINBERG, P.C.
The Frick Building, Suite 200
Pittsburgh, PA 15219
(412) 281-8400

MICHAEL D. DONOVAN
(Counsel of Record)
PAMELA P. BOND
CHIMICLES, JACOBSEN & TIKELLIS
361 W. Lancaster Avenue
Haverford, PA 19041
(610) 642-8500

Counsel for Petitioner

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

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REPLY STATEMENT

Respondent ("Citibank") has abandoned much of the lower court's reasoning by denying that the first two issues accepted for review are even at issue. There can be no doubt, however, that those issues remain critical. Petitioner maintains that a national bank's rate authority is bounded by the plain, common law meaning of "interest" and "rate" in 12 U.S.C. § 85 (1994) ("§ 85"). She contends that such a boundary is necessary to avoid an unconstitutional delegation of limitless national lawmaking authority to a bank's home state. In response, Citibank and the Office of the Comptroller of the Currency ("OCC") feign agreement that "interest at the rate" must be defined by federal law, recognizing that only Congress can preempt state law. *See* Resp. Brf. 14 n.5; U.S. Amicus Brf. 23. But Citibank then argues that § 85's rate authority extends to all charges and terms allowed by a bank's home state that have an economic connection to the bank's rate. *Cf.* Resp. Brf. 22, 48-49 (home state determines charges included in "rate").[1] Citibank contends that such broad authority is necessary to avoid potentially hostile state laws that could set a low interest rate while allowing other charges for other lenders. So the question that combines all three issues here is whether § 85 simply adopts the allowed "rate" of "interest" (even an unlimited rate) of a bank's home state, as urged by petitioner, or operates as a broader federal choice of law provision that federalizes practically all of the statutory and decisional law of a bank's home state that has any effect on the bank's loan yields. *See* Colorado, *et al.* Amicus Brf. 2-3 (arguing that § 85 is a boundless federal choice of law provision).

Though § 85 clearly displaces state regulation of interest "*rates*," *see Marquette Nat'l Bank v. First of Omaha Serv. Corp.*, 439 U.S. 299, 319 & n.31 (1978), Congress has not clearly stated that the statute also preempts nondiscriminatory

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[1] In effect, Citibank wants to have it both ways – an all-inclusive federal definition that depends on the home states of banks to determine the charges included in the interest rate and, in turn, the preemptive scope of § 85.

state contract laws limiting default penalties such as Citibank's credit card late fees. Section 85 uses the phrase "interest at the rate" to refer to charges that, at the outset, can be, in the words of the statute, "reckoned [to] the days" and to the amount of the debt. 12 U.S.C. § 85. Even as detention charges, the late fees here are not charges that are calculable at the outset based on the time and the amount of the late payment. Accordingly, § 85 does not preempt California's contract laws limiting Citibank's late fees.

Once "interest at the rate," by any rate measurement – state or federal – is conceded to have an objective federal definition, settled principles of federalism define the preemptive scope of the term. *Bowen v. American Hosp. Ass'n*, 476 U.S. 610, 644 & n.33 (1976). These fundamental principles override any exaggerated estimates of the liability at stake here, particularly given the 19.8% and even higher interest rates (JA 53) Citibank is permitted to charge and the fact that most states already permit some limited form or amount for contractual late fees.[2] Because Congress retains the authority to expand the powers of national banks to export non-interest charges limited only by federal standards, and because only then will the political safeguards of federalism be brought into focus on the question of all credit-related terms, "interest at the rate" should be construed to mean precisely what it says – a charge measurable at the outset by a rate based on time and the payment owed. *See Barnett Bank v. Nelson*, No.

[2] The contention that it would be inefficient or disruptive to subject banks to the non-interest contract laws of a borrower's state is belied by respondent's own amici. For example, the briefs of both the Affinity Marketing Group, et al., and the American Bankers Association, et al., in support of respondent, make it clear that card issuers routinely tailor their credit card packages to unique and even individual conditions or preferences. *See* Affinity Amicus Brf. 2; ABA Amicus Brf. 23. Although a borrower's state may choose to regulate non-interest charges to channel competition and comparative shopping towards the important pricing term of the interest rate, that decision does not interfere in any way with an out-of-state bank's right to charge the highest *rate* allowed by its home state. Indeed, nothing prevents Citibank in this case from charging a higher time-based rate to late payers than to timely payers. Congress also reasonably could have concluded that only the central price component, the interest rate, deserved specific attention in the NBA.

94-1837, 64 U.S.L.W. 4161, 4164, 4166 (U.S. Mar. 26, 1996) (requiring notice so affected parties can focus on the likely effects of proposed legislation). Given the absence of any indication that Congress intended to displace broadly not just the rate ceiling of the borrower's state but also virtually all of that state's loan-related contract laws with another state's rate definition or ceiling, the California Supreme Court's ruling must be reversed.

ARGUMENT

I. THE MOST FAVORED LENDER DOCTRINE DOES NOT OBLITERATE THE PRINCIPLES OF FEDERALISM.

Underlying all the arguments of respondent and its amici is an unconstitutional expansion of the most favored lender doctrine. Though most favored lender status protects national banks from state discrimination with respect to interest rates, it does not displace the individual states' authority to enact and enforce evenhanded contract, tort and consumer protection laws regulating loan charges or terms other than interest rates. Instead of being paramount to all other considerations, the doctrine operates in conjunction with federalist principles. *Cf.* Cong. Globe, 38th Cong., 2d Sess. 2124 (1864) (Remarks of Sen. Trumbull) ("This provision of the bill [section 30] is not an interference with the States, but on the other hand an agreement with the States.").

Rejecting this point, Citibank premises its main argument on the mistaken belief that "interest at the rate" should be defined by the economic consequences to the bank. Citibank suggests that Congress used this phrase to authorize as "interest" all additional administrative and collection charges imposed by a bank. *See* Resp. Brf. 14, 30. Citibank then suggests that the charges exportable as part of its allowed rate must be defined with reference to the "laws of the home state of the national bank" so interest can be "adjusted to local conditions." Resp. Brf. 48. In effect, all of these arguments improperly condition either the meaning of "interest" or the definition of "rate" on the laws of the bank's home state.

"Congress did not intend such an improbable result." *First Nat'l Bank v. Dickinson*, 396 U.S. 122, 133-34 (1969).

The clear language of the statute ordinarily determines legislative intent; policy perceptions do not. *West Virginia Univ. Hosp. Inc. v. Casey*, 499 U.S. 83, 99-100 (1991). Here, even Citibank agrees that "interest at the rate" means, at a minimum, a charge measurable ("reckon[ed]") at the outset by time and the unpaid balance. *See* 12 U.S.C. § 85. No purpose of the National Bank Act ("NBA") requires a different reading. Nor would any Congressional purpose be frustrated by the same literal reading this Court required in *Tiffany v. National Bank of Missouri*, 85 U.S. (18 Wall.) 409, 410 (1874). In fact, this Court has rejected virtually the same "bundle" or "package" policy arguments that Citibank asserts throughout its brief to justify a broader interpretation (Resp. Brf. 12, 35, 50). *See New York State Conf. of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.*, 115 S. Ct. 1671, 1677 (1995) (rejecting package preemption).

Contrary to respondent's speculative claims of potential rate discrimination, it is clear that Citibank derives its ability to charge the type of late fees at issue here not from § 85, but from 12 U.S.C. § 24 (1994) ("§ 24"). That statute empowers national banks to enter into contracts and to impose incidental charges "subject to law." *Id.* While § 24 might preempt a state law that prohibited or "significantly interfered" with a bank's power to make contracts, neither Citibank nor the OCC has contended or could contend that California's contract laws regulating the late fees here prohibit or "significantly interfere" with that ability.[3] *Cf. Barnett Bank*, 64 U.S.L.W. at 4163 (state law prohibiting any exercise of express power is preempted). Absent the type of "significant interference"

[3] Such an argument would be absurd, for it would necessitate a vast federal common law of banking contracts that would displace countless state laws impacting upon ordinary loan agreements, including the statute of frauds and even the Uniform Commercial Code. *See O'Melveny & Myers v. Federal Deposit Ins. Corp.*, 114 S. Ct. 2048, 2053-55 (1994); *Cf. Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 213-14 (1976) (agency cannot enlarge statute).

reflected in *Barnett Bank*, *see id.*, state contract laws, including conflict of laws principles, must apply to national banks. *See id.*; *see also First Nat'l Bank v. Kentucky*, 76 U.S. (9 Wall.) 353, 362 (1870). Indeed, the banks themselves have historically depended on these very state contract laws to give effect to all their transactions.

As the Solicitor General now admits, wholly apart from § 85 and the most favored lender doctrine, the NBA already prevents a bank's home state from discriminating against the bank (U.S. Amicus Brf. 8, n.1). *See Anderson Nat'l Bank v. Luckett*, 321 U.S. 233, 247-49 (1944); *Sherman v. Citibank (S.D.), N.A.*, 143 N.J. 35, 68-70, 668 A.2d 1036, 1052-53 (1995), *petition for cert. filed*, No. 95-991, 64 U.S.L.W. 3439 (Dec. 21, 1995). Thus, Citibank's argument that, if "interest" does not include the late fees at issue here, South Dakota could permit its state-chartered banks to assess such late charges without extending that same privilege to national banks is wrong. Regardless of § 85, a national bank can charge sum-certain late fees in its home state as a matter of non-discriminatory state contract laws.

If the NBA was intended to displace all state contract and tort laws that might have an indirect economic impact on the terms or pricing of loan agreements by national banks, established principles of federalism required Congress to put the states on notice of that intent. *See Gregory v. Ashcroft*, 501 U.S. 452, 464 (1991). Without such notice, the political safeguards of federalism cannot function, particularly where, as here, there is no direct conflict between a federal power and a state rule. In fact, the state rule (Cal. Civ. Code § 1671) is not a rate ceiling, but rather an evenhanded fee limitation that is completely consistent with the federal rate law and is imbedded in the general contract and common laws of the state. Petitioner's analysis, then, besides incorporating federalist principles, coincides with the most favored lender doctrine.[4]

[4] Citibank and its amici mistakenly insist that a borrower's state has little interest in regulating contractual credit terms offered in the state by out-of-state lenders. *See, e.g.*, Resp. Brf. 12. Congress and countless courts have rejected that

Citibank incorrectly dismisses the important issues of federalism in this case. Those issues are highlighted by this Court's consideration of the preemptive scope of the federal discount rate measurement for "interest" in *Marquette*. *See* 439 U.S. at 318 n.31 ("[t]o the extent the enumerated federal rates of interest [discount rate plus 1% or 5%] are greater than permissible state rates, state usury laws must, of course, give way"). The scope of preemption for the federal discount rate measure in § 85 cannot depend in any way on the law of the bank's home state, for that law itself would be preempted. Just as the presumption against preemption must confine the preemptive scope of the discount rate alternative, so too must it confine the preemptive scope of the state rate alternative. *Cf. National Bank v. Johnson*, 104 U.S. 271, 277-78 (1881) (discount interest and loan interest are the same). As we describe below, established principles of federalism limit the preemption effected by either rate measure to the rate ceiling of the bank's or the borrower's state.

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very position. For example, in enacting the RIEGLE-NEAL INTERSTATE BANKING AND BRANCHING EFFICIENCY ACT OF 1994, PUB. L. NO. 103-328, § 114, 108 STAT. 2367, Congress expressly found that the customer's state has a significant interest in regulating consumer protection and redlining issues. *See* H.R. CONF. REP. NO. 651, 103d CONG., 2d SESS. 53 (1994), *reprinted in* 1994 U.S.C.C.A.N. 2039, 2068-74; *see also Sherman*, 143 N.J. at 68-71, 668 A.2d at 1052-53; *Mazaika v. Bank One (Columbus), N.A.*, 439 Pa. Super. 95, 115, 653 A.2d 640, 650 (1994), *alloc. granted*, 659 A.2d 557 (Pa. 1995). In addition, Congress expressly provided in that Act that branches of out-of-state banks will be subject to and controlled by the laws of their host states with respect to non-interest consumer protection laws, thus precluding application of the laws of the parent bank's state. *See* 12 U.S.C. § 36(f)(1) (Supp. 1995); *see also* H.R. CONF. REP. NO. 651 *supra* at 13, 53. Similarly, federal and state courts have uniformly found that a borrower's home state has a compelling interest in regulating the credit terms offered in that state by solicitations originating out-of-state. *See, e.g., Aldens, Inc. v. Packel*, 524 F.2d 38, 43, 48-49 (3d Cir. 1975), *cert denied*, 425 U.S. 943 (1976); *Aldens, Inc. v. LaFollette*, 552 F.2d 745, 750-51 (7th Cir.), *cert. denied*, 434 U.S. 880 (1977); *Aldens, Inc. v. Ryan*, 571 F.2d 1159, 1161 (10th Cir.), *cert. denied*, 439 U.S. 860 (1978); *Turner v. Aldens, Inc.*, 179 N.J. Super. 596, 602, 433 A.2d 439, 442 (App. Div. 1981).

II. CITIBANK'S CLASSIFICATION OF ALL LENDING CHARGES AS INTEREST IGNORES THE COMMON LAW OF PENALTY CHARGES.

When a statute is unambiguous, the plain English meaning of its language ordinarily controls. *See United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 242-43 (1989). In the absence of specific definitions, unique constructions are irrelevant because the words used are presumed to have a common law meaning. *See United States v. Texas*, 507 U.S. 529, 534 (1993).

Here, § 85 plainly provides that only "interest at the rate" allowed by the bank's home state may be exported. Citibank's late fees cannot be interest because they lack the two fundamental characteristics of interest – they are not and cannot be computed ("reckon[ed]") at the outset based on either the *amount of time* the money has been withheld by the borrower or *the amount owed* by the borrower. As petitioner demonstrated in her opening brief (*see* Pet. Brf. 30-39), interest on a loan detention includes components of both the amount owed and the time for which it is owed. For the late fees challenged here, neither component is present. Thus, a borrower who owes $50 and a borrower who owes $5,000 are both charged the same late fee. Similarly, a late borrower is charged the same late fee on a thirty-day revolving account whether he is one day or twenty-nine days late.[5]

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[5] Contrary to respondent's suggestion, petitioner does not object to the imposition of Citibank's late fees simply because they are expressed in terms of a flat fee rather than as a percentage. Whether the absolute dollar figure charged is expressed as a flat fee or as a percentage figure is not dispositive. It is because the late fees at issue do not bear any relation to the payment owed or to the amount of time the money has been withheld that they are *not* interest. Respondent further mischaracterizes petitioner's position by casting it in terms of an objection to the excessive amount of the late fee here. Although the fee far exceeds the bank's cost, that is not why it falls outside of § 85. Whether the type of late fee here was one dollar or one hundred dollars, the principle that the late fees at issue bear no relation to the amount of time the money was retained or the amount of money owed remains the same. Moreover, the OCC's assertion that the late fees here are monthly charges (U.S. Amicus Brf. 15) is incorrect. The late fees are imposed for any failure to pay within 25 days of the due date. (JA 56). Certain of the fees (JA 74) also are

Citibank states that there is no "logical or economic reason" single-sum penalty charges should not be considered interest. Resp. Brf. 24. To the contrary, one such reason is identified in respondent's own brief: if single-sum default charges were "interest," it would "not be possible to determine whether a certain late charge exceed[ed] a given percentage ceiling until *after* the charge [was] actually incurred." *Id.* (emphasis added). A national bank must be able to determine whether a charge is excessive *before* the charge is imposed so it can avoid the severe penalties of either forfeiture or double the amount of interest collected pursuant to 12 U.S.C. § 86 (1994) ("§ 86").[6] Indeed, this Court has emphasized that §§ 85 and 86 must be construed "strict[ly]" and "literal[ly]" to avoid the imposition of penalties on national banks. *See Tiffany*, 85 U.S. at 410; *Keppel v. Tiffen Sav. Bank*, 197 U.S. 356, 362 (1905). Congress could not have intended to establish a system in which national banks and their borrowers could not predict or prevent usury violations until *after* the usurious charges were imposed. Congress must have intended instead a system in which state common law would regulate single-sum penalties as contractual liquidated damages, not as "interest" or usury. Respondent's implausible analysis does not prove a contrary or broader intention. *See* Pet. Brf. 36-37.

In her opening brief, petitioner cited myriad of cases applying contract principles to penalty charges and distinguishing those principles from statutory interest and usury standards. *See, e.g.*, *New Orleans Ins. Co. v. Piaggio*, 83 U.S. (16 Wall.) 378, 386 (1872) ("[a lender] cannot recover special damages for the detention of money beyond what the law allows as interest"); *see also United States v. Texas*, 507 U.S. at 536.

In response, Citibank attempts, without success, to distinguish a few of the many cases holding that additional

imposed twice per billing period, which violates California's current law, Cal. Fin. Code § 4001.

[6] This point distinguishes virtually all of Citibank's cases. Many of those state cases involve either forbearance charges or closed-end loans, where, unlike here, both lender and borrower could determine compliance with the usury ceiling *before* the charges were imposed. *See, e.g.*, *Craig v. Pleiss*, 26 Pa. 271 (1856).

contract penalties are *not* interest. Citibank says, for example, that *United States v. Texas* should be ignored because it did not involve the NBA or address "interest" in the same context as this case. In fact, *United States v. Texas* specifically examined the common law of prejudgment interest, which is the same law that defines damages for delay in the payment of money. *See* 507 U.S. at 536. In reviewing that common law, this Court observed that late fees and penalties are "more onerous than the common law" of prejudgment interest. *See id.* at 536. Neither *Brown v. Hiatts*, 82 U.S. (15 Wall.) 177 (1873), nor *Shoemaker v. United States*, 147 U.S. 282 (1893), relied upon heavily by Citibank and its amici, address these additional sum-certain charges imposed beyond the contract interest rate to punish or deter a late payment.

More important, the *Brown* definition of "compensation allowed by law, or fixed by the parties, for the use or forbearance of money, or as damages for its detention," 82 U.S. at 185, advanced by Citibank, simply does not answer the definitional question presented here. Unlike *United States v. Texas*, *Brown* did not consider the common law scope or meaning of "damages for [the] detention [of money]." Since *Piaggo* and *United States v. Texas* addressed that very common law, and found that late fee penalties are beyond the concept of interest as damages, it explains the very general and otherwise unhelpful definition of *Brown*. Accordingly, *Piaggo* and *United States v. Texas* are both relevant and instructive.

Citibank and the OCC also incorrectly state that the term "rate" in § 85 is synonymous with the word "amount." *See* Resp. Brf. 24; U.S. Amicus Brf. 13. In fact, § 85 uses "rate" to mean the "reckoning [of] the days for which the note, bill, or other evidence of debt has to run." 12 U.S.C. § 85. Unlike the word "amount," the word "rate" has a ratio relationship to time. This is further underscored by the fact that section 30, 13 Stat. 108 (1864) (now divided into §§ 85 and 86) clearly uses the different terms "interest at the *rate*" and "twice the *amount* of interest paid" to refer to different things. Interest "*rate*" refers to the bank's compensatory charge, while "*amount* of interest" refers to the aggregate sum

of money improperly collected by the bank.[7] Although the word "rate" in different contexts can mean different things, in the context of interest and lending, it means a "ratio of the interest to the principal for each unit of time." JUSTIN A. MOORE, HANDBOOK OF FINANCIAL MATHEMATICS 2 (1929). Hence, the strained contention of Citibank and the OCC that "rate" means "amount" is unsupported by the statutory usage.

Misdirecting the Court to an expansive construction of "rate," respondent and the OCC misstate the holding of *Citizens' Nat'l Bank v. Donnell*, 195 U.S. 369 (1904). *See* Resp. Brf. 4; U.S. Amicus Brf. 16. In *Donnell*, this Court focused on the effect that the bank's compounding of interest had on the actual "rate" charged by the bank. *See* 195 U.S. at 374 ("[t]he rate of interest . . . is greater when [the bank] is allowed to compound"). Because the compounding of interest within one year caused the bank's rate to exceed the state's *per annum* rate ceiling, the Court upheld the finding of usury. Given that holding, the Court disregarded the bank's monthly loan advance charge, stating "[t]he suggestions as to the 12 percent charge on overdrafts do not seem to us to need answer." *Id.* at 374. Citibank and the OCC misinterpret this passage as a finding that penalties are "interest." But this Court never even addressed that question, since all the parties in *Donnell* recognized that penalties (in contrast with agreed loan advances) are not interest within the meaning of § 85.[8] Hence, *Donnell* actually supports petitioner, not Citibank.

Citibank's heavy reliance on *Daggs v. Phoenix Nat'l Bank*, 177 U.S. 549 (1900), for a broad definition of "rate" (*see* Resp. Brf. 24) is equally misplaced. In that case, Arizona

[7] Obviously, it would be impossible for a borrower to recover as a penalty for usury twice "the [rate] of interest" paid to a national bank, for that penalty does not indicate any base for the measurement.

[8] *See Citizens' Nat'l Bank v. Donnell*, 72 S.W. 925, 933 (Mo. 1903) (observing that the monthly loan advance charge was not a penalty because the bank had "consented to the overdraft"). Unlike the bank in *Donnell*, respondent here has not consented to a cardholder's late payment. It has instead defined a late payment as a contractual default for which it will not forbear even if the late fee is paid. (JA 58).

allowed the parties to "agree in writing for the payment of any *rate* of interest." 177 U.S. at 554 (emphasis added). Because Arizona did not "fix" a rate ceiling for written agreements, Daggs argued that the federal rate of 7% provided the rate-cap for the Phoenix National Bank. This Court held that the proper focus was not on a rate "*Fixed by the laws*" of the Territory but on the rate "*allowed by the laws*" of that Territory. *Id.* at 555 (emphasis in original). Since Arizona allowed any *rate* agreed to in writing, the national bank was also authorized to charge any "*rate*" in its written contracts. *See id.*

Contrary to Citibank's contention, *Daggs* is limited to a time-based *rate*. While the *Daggs* Court distinguished *National Bank v. Johnson*, 104 U.S. at 278, *see* 177 U.S. at 556, it did not cast any doubt on the holding in *Johnson*, as later reiterated in *Evans v. National Bank*, 251 U.S. 108, 111 (1919), that § 85 adopts only the maximum allowed interest "*rate*" of a bank's home state. As the Court in *Evans* explained, § 85 does not adopt all of the loan yield laws of the bank's home state that might have an indirect impact on the rate. Compare *Evans*, 251 U.S. at 111-114 (majority opinion) with *id.* at 115-120 (dissenting opinion); *Travelers*, 115 S. Ct. at 1676-80 (rejecting package preemption based on charges "related to" a plan or rate).

While Citibank and the OCC deny that the first two issues addressed by petitioner are even at issue, their reading of *Daggs* makes clear that those issues are pivotal. Inasmuch as Citibank concedes that its home state's law cannot define "interest at the rate" in § 85, *Daggs* must be confined to the federal meaning of "interest" and "rate." A contrary reading would effectively delegate unlimited power to determine the preemptive scope of § 85 to the different statutory and decisional laws of each of the fifty states. Congress could not have intended that result. *See Dickinson*, 396 U.S. at 133-34; *Seattle Trust & Sav. Bank v. Bank of California, N.A.*, 492 F.2d 48, 50-52 (9th Cir.), *cert. denied*, 419 U.S. 844 (1974).

Urging a broad definition, respondent also contends that "interest" has different meanings in different contexts. But that begs the question. When Congress used the term "interest

at the rate" in § 85, it could not have intended for banks and state legislatures to pick and choose, at their convenience, what the term means. When the words are read together in the context of the statute, "interest at the rate" means an agreed-upon charge calculable ("reckon[ed]") at the outset by time and the payment owed. The only charges that can constitute "interest" then are those that can be determined from the beginning to bear some ratio relationship to the amount and duration of the debt.[9]

In sum, Citibank's "all lending charges" theory conflicts with the plain meaning of § 85, misconstrues the common law, and overstates the purposes of § 85 and the most favored lender doctrine.[10] More important, Citibank's proffered definition is far broader than even the agency definition for which Citibank requests judicial deference. As we detail below, the definition currently espoused by the OCC, though somewhat narrower, also violates § 85 and is unworkable.

[9] Here, Citibank continues to collect precisely the same rate of interest as it would otherwise collect from a timely paying cardholder. Unlike a percentage, time-based fee on a precomputed closed-end loan, Citibank's open-end late fee is not in any way a compensatory charge calculable at the outset as a rate based on time and the payment owed. Even the $6.00 plus a separate .65% charge for Citibank's Preferred Cards (*see* JA 74) is noncompensatory because it is calculated based on the entire outstanding balance and not on the actual payment amount that is late.

[10] The OCC's interpretation also fails to recognize the "*id quod interest*" principle, which measures "the difference between the creditor's current position and what it would have been if the loan had been timely and fully repaid." *Library of Congress v. Shaw*, 478 U.S. 310, 315 n.2 (1986). An example of "*id quod interest*" is found in *Brown v. Hiatts*, 82 U.S at 185 (interest accrues or runs). This detention interest (prejudgment interest) has never included additional sum-certain penalties like Citibank's late fees. *See United States v. Texas*, 507 U.S. at 536; *Library of Congress*, 478 U.S. at 322 ("Private-sector decisions, when they adjust for the time of payment, grant interest or a delay factor, but not both."). In fact, a lender was not allowed to recover more than "*id quod interest*" for a loan default. *Piaggio*, 83 U.S. at 386. Accordingly, the OCC's assertion that the late fees here are "interest" ignores relevant precedent and misinterprets the plain meaning of § 85.

III. THE REGULATORY MATERIALS CITED BY CITIBANK DO NOT WARRANT JUDICIAL DEFERENCE.

Both Citibank and the OCC urge this Court to defer not to an agency rulemaking pursuant to § 85 but to an agency interpretation issued over 130 years after the statute was passed. The OCC's very recent interpretation of "interest" must be rejected because it is not a permissible construction of the statute, it exceeds the agency's jurisdiction, and it conflicts with basic preemption principles.

The OCC does not attempt to justify its new interpretation based on any administrative expertise. Instead, the OCC acknowledges that defining interest is a straightforward question of statutory construction and that the primary reason for including "late fees and overlimit fees" as interest is that "[m]any courts interpreting 12 U.S.C. § 85 have concluded that various forms of non-percentage-based charges (including such items as late payment, overlimit, and annual fees) for the use of borrowed money fall within the scope of 12 U.S.C. § 85." 61 Fed. Reg. 4858-59 (Feb. 9, 1996) (Pet. Rep. Brf. App. A). Thus, in effect, Citibank and the OCC ask for deference to an agency position which is predicated almost exclusively upon the opinions of lower courts. Petitioner knows of no case – and especially not *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984) – in which an agency has obtained deference on the basis that its decision reflects "current case law," 61 Fed. Reg. 4858.[11] Certainly no such deference is warranted here.

Petitioner has already shown that the plain meaning of the statutory term leaves no doubt about Congressional intent. The Court should not defer to an agency interpretation inconsistent with the plain meaning of the statute.

The OCC's recent interpretation is not a "permissible construction" because it is subjectively based on labels instead

[11] Any deference to the Comptroller's current interpretation also must be discounted because it was a post-hoc, litigation-inspired reaction to ongoing credit card fee litigation, in which the agency participated as amicus on the side of the banks. *See Bowen v. Georgetown University Hosp.*, 488 U.S. 204, 212-13 (1988).

of substance. *See Chevron*, 467 U.S. at 863. The OCC has redefined "interest" broadly to include "any payment compensating a creditor or prospective creditor for an extension of credit, making available of a line of credit, or any default or breach by a borrower of a condition upon which credit was extended." 61 Fed. Reg. 4869. Purportedly based on this definition, the interpretation then subjectively categorizes various charges into "interest" and "non-interest." However, there is no rational basis for distinguishing the various charges the OCC has denominated interest ("numerical periodic rates, late fees, not sufficient funds (NSF) fees, overlimit fees, annual fees, cash advance fees, and membership fees") from those charges it has denominated "non-interest" ("appraisal fees, premiums and commissions attributable to insurance guaranteeing repayment of an extension of credit, finders' fees, fees for document preparation or notarization, or fees incurred to obtain credit reports"). *See id.* As these subjective categorizations make clear, the OCC, without any delegated authority or discernible standards to limit its subjective decisionmaking, has accorded itself boundless authority to expand or limit the meaning of "interest at the rate" in § 85.[12]

In particular, the agency's recent definition fails to provide any substantive, objective basis on which to distinguish "interest" from "non-interest" charges. Some of the OCC's non-interest fixed charges, such as closing fees for appraisal, document preparation and credit reports, are the kind of ordinary credit expenses which lower courts have treated as "interest." *See, e.g., Northway Lanes v. Hackley Union Nat'l Bank & Trust Co.*, 464 F.2d 855, 864 (6th Cir. 1972) (closing costs found to be "interest" in case where OCC appeared as *amicus curiae*). In contrast, other charges the OCC now denominates as "interest," such as annual and payment system fees that are far removed from any actual extension of credit, traditionally have *not* been considered interest. *Cf. Milwaukee Brewery Workers' Pension Plan v. Jos. Schlitz Brewery Co.*, 115 S. Ct. 981, 988 (1995) ("In our view, one generally does not pay interest on a debt until that debt arises – that is to say, until the principal of the debt is outstanding"). Apart from elevating the label of a charge over the substance of that charge, there is no principled basis for the distinctions the OCC has drawn.

The omissions from the OCC's listing of "interest" further establish the unreasonableness of the OCC's interpretation of the statutory term. For example, the interpretation fails to address the important loan-related fees of prepayment penalties, attorneys' fees and court costs. If prepayment penalties, attorneys' fees and collection costs are not "interest," there is no principled basis for concluding that the late fees here are interest. *Cf.* 61 Fed. Reg. 11301 (Mar. 20, 1996) (OCC rule treating prepayment fees on mortgage loans as non-interest fees). Even worse, if prepayment penalties and other such charges are "interest," then national banks across the country will confront usury claims each time a prepayment penalty or attorneys' fee causes the rate charged by the bank to exceed the applicable rate ceiling in the bank's home state.

Another example of unreasonableness is found in the OCC's explanation of the "*[e]ffect on state definitions of interest*" in subparagraph (c) of the interpretation, 61 Fed. Reg. 4869. (*See* Pet. Rep. Brf. App. A). Both Citibank and the OCC have insisted that late fees must be "interest" because a contrary rule would allow states to discriminate against national banks by setting low percentage rate ceilings while allowing other lenders to charge late fees. Indeed, Citibank expressly describes "[t]he issue" as "whether flat charges for borrowed money are 'interest,' such that they count against [the home state's] 'rate' ceiling; if not, the state's ceiling could be evaded with impunity." Resp. Brf. 23. Subparagraph (c) of the OCC's interpretation, however, inconsistently provides that late fees are interest for the purpose of preempting

[12] Given the absence of any delegated authority or standards, the Court should reject the OCC's attempt to do through "interpretation" what the agency cannot do and has not done through formal rulemaking. Where, as here, Congress has not provided any guidelines or standards for determining the scope of federal preemption or for checking the exercise of delegated authority, the delegation is unconstitutional. *See Panama Refining Co. v. Ryan*, 293 U.S. 388, 418, 421 (1935). To avoid that result, "interest at the rate" should be read narrowly. *Cf. National Cable Television Ass'n v. United States*, 415 U.S. 336, 342 (1974) (construing statute "narrowly" to avoid unconstitutional delegation).

the contract laws of other states but should "not be treated as interest for purposes of evaluating compliance with state usury limitations, or [rate ceilings]" if the home state does not include late fees in calculating its maximum rate of interest. 61 Fed. Reg. 4869. Thus, the OCC's interpretation defines late fees as both "interest" and "non-interest" depending on the "rate" definitions of the bank's home state. *See id.* at 4858 (state law determines what lending charges are permitted). Presumably, this divergent, confusing and inefficient "effect on state definitions" would also apply to all the other fees the OCC has defined as "interest."

This inconsistent "effect" is equally unreasonable where a state's rate ceiling for all lenders includes more charges than the OCC's definition includes. For example, if a state's statutory ceiling embraces charges the OCC has now denominated as "non-interest," such as appraisal fees, a national bank in that state presumably would have to adjust the allowed ceiling by subtracting the appraisal fee component to arrive at the actual "rate" allowed in the state. Any different rule would have the "effect" of preempting the state's allowed *rate* with a federal non-interest charge even though Congress has expressly consigned the rate ceiling to state decisionmaking. Although there is no principled basis for treating a more inclusive state ceiling any differently from one that is less inclusive, for the OCC's interpretation to work in practice, the rate ceiling adjustment or "effect" would have to apply only in less inclusive states. Banks in the more inclusive states, therefore, effectively could ignore the home state's rate ceiling altogether because they could charge any amount for the non-interest fees. Of course, that results in the same low-ceiling/high fee problem the OCC and respondent inconsistently insist must be avoided with respect to late fees.[13]

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[13] Presumably, the dual "interest"/"non-interest" effect described by the OCC is intended to account for those states with relatively low interest rate ceilings that do not consider late fees to be interest. *See, e.g.*, Letter to OCC from Senators Pryor and Bumpers (Pet. Rep. Brf. App. B). While the late fees would be federal "interest" in such states, under the OCC's interpretation they would not be interest within the meaning of the "rate" allowed pursuant to § 85 and, therefore, would not

Subparagraph (c) is equally unworkable when national banks opt for the alternative § 85 rate of 1% over the federal discount rate. *See Marquette*, 439 U.S. at 318 n.31 (noting the preemptive effect of the federal rate option). While late fees and other fees *would not be counted* toward the rate ceiling if the bank's home state did not define "interest" to include these fees, according to subparagraph (c) they apparently *would be counted* toward the alternative federal rate ceiling. Banks opting for the federal rate would then have to either refrain from charging any other fees or create massive monitoring systems to ensure that any default fees charged did not cause the rate to violate the federal ceiling. Obviously, such an inconsistent scheme is neither uniform nor efficient from the banks' or the consumers' perspective. In short, whatever deference the Court might be inclined to afford the OCC in other circumstances, its lack of any rationale for the subjective labelling distinctions that it drew (and failed to draw) completely undermines its very recent position equating the late fees here with interest.

Apart from being unreasonable, deference is also inappropriate because Congress has directed the judiciary, not an executive agency, to interpret §§ 85 and 86. Unlike other cases calling for agency deference, this case involves "a pure question of statutory construction" that does not depend on any agency expertise or adjudicatory deliberation. *See INS v. Cardoza-Fonseca*, 480 U.S. 421, 446 (1987). Petitioner has not challenged the general corporate powers of a national bank under the NBA. Rather, petitioner has questioned only whether evenhanded state contract laws that do not prohibit or even interfere with those powers, and, in fact, give life and substance to those very powers, may be enforced in ordinary transactions involving national banks just as they are enforced by the banks themselves. The OCC's recent interpretation

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be counted against the state's rate ceiling as incorporated into § 85. In such states, subparagraph (c) apparently would allow a national bank to export both the rate ceiling *and* additional late fees. This effect violates § 85, for it overrides the "rate allowed by the laws of the State," and sets no limit on any of the fees exported by the bank, even though such fees may be separately regulated by the home state.

here is neither a safety and soundness rule, overriding all state limitations on credit-related fees, nor a corporate powers rule. Accordingly, it is the province and duty of this Court to say what the law is in this case.[14]

In response, both Citibank and the OCC, citing the OCC's general supervisory and enforcement authority, attempt to distinguish this Court's rejection of agency deference in the analogous case of *Adams Fruit Co. v. Barrett*, 494 U.S. 639 (1990). In *Adams Fruit*, the Court rejected a plea for deference to an interpretation by the executive department responsible for enforcement of the federal statute at issue. The Court observed that the statute expressly established the judiciary and not the executive agency as the adjudicator of rights arising under the statute, just as § 86 of the NBA establishes the judiciary and not the OCC as the adjudicator of rights under § 85. The Court in *Adams Fruit* reasoned that because Congress had established an enforcement scheme with direct recourse to the courts, it was inappropriate to consult executive interpretations to resolve ambiguities concerning the preemptive scope of the statute. *Adams Fruit*, 494 U.S. at 650-51. The same principles necessarily apply here.[15]

[14] The OCC's reliance on 12 U.S.C. § 93a (1994) for preemptive rulemaking authority here is misplaced. *See* U.S. Amicus Brf. 21. Section 93a was enacted in 1980 as part of the Depository Institutions Deregulation and Monetary Control Act of 1980 ("DIDA"), Pub. L. No. 96-221, 94 Stat. 188. As noted in petitioner's opening brief, DIDA did not provide any notice to the states that their general contract laws would or could be overridden by federal administrative preemption of their states' statutory usury ceilings. *See* Pet. Brf. 42-43. By also authorizing the OCC to issue rules "to carry out the responsibilities of the office," 12 U.S.C. § 93a, Congress did not signal that the Federal-State balance could be "significantly changed" by OCC rulemaking. *See Bowen v. American Hosp. Ass'n*, 476 U.S. at 644 & n.33. Hence, unlike *Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta*, 458 U.S. 141 (1982), the political safeguards of federalism have never been brought to bear on the expansive interpretations advanced by respondent and the OCC here. Nor has Congress provided any standards to guide or limit the OCC's subjective interpretive authority. *Cf. National Cable Television Ass'n*, 415 U.S. at 342 (abjuring deference and construing statute "narrowly" to avoid delegation problems).

[15] The OCC's contention that 12 U.S.C. §§ 93 and 1818 vitiate the holding of *Adams Fruit* is incorrect. Section 93 authorizes the OCC to enforce the provisions of the NBA, but it does not provide any separate standards to guide that enforcement authority. Section 1818 is part of the Federal Deposit Insurance Act and addresses the OCC's power to terminate the charter of an insured depository institution. Neither section displaces the exclusive judicial forum chosen by Congress in §§ 85 and 86 for the construction of a bank's interest rate charges or provides any guidelines for or limits on the OCC's preemptive powers.

Finally, deference to the OCC's interpretation is inappropriate here because federal preemption is at issue. *Cf. Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 151-52 (1963) (reflecting concern for preemptive delegation); Laurence H. Tribe, American Constitutional Law § 6-26, 496-97 (2d ed. 1988) (analyzing *Florida Lime*). As the OCC concedes, deference to an agency opinion is proper only when the statute is "silent or ambiguous." *Chevron*, 467 U.S. at 843 ("If the intent of Congress is clear, that is the end of the matter"). *See* U.S. Amicus Brf. 11. When the statute is "silent or ambiguous," and does not otherwise provide standards for an agency to issue preemptive rules having the force of law, the presumption against preemption necessarily requires a finding that federal law does *not* preempt state law. *See Cipollone v. Liggett Group, Inc.*, 505 U.S. 504, 516 (1992) (preemption, if it is intended, must be "clear and manifest"). Stated another way, when, as here, the statute does not set standards for agency preemption through rulemaking,[16] deference to a preemptive agency interpretation is misplaced,

[16] The OCC apparently believes that the notice requirements of 12 U.S.C. § 43 (Supp. 1995) are sufficient. Section 43 was enacted as part of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, Pub. L. No. 103-328, § 114, 108 Stat. 2367. Finding that the bank regulators were issuing overly aggressive opinions preempting state laws, Congress mandated in that Act that any opinion by the OCC that might have a preemptive impact must first be published for notice and comment and describe "each" state law likely to be affected. *Id.*; H.R. Conf. Rep. No. 651, *supra* at 55, 1994 U.S.C.C.A.N. at 2068-74. Section 43 did not, however, grant any new or additional power to preempt state law or set any standards for the preemptive decisions. *See id.* (the notice "process is not intended to confer upon the [OCC] any new authority to preempt or to determine preemptive Congressional intent"). Here, the OCC violated section 43 by failing to describe "each" state law likely to be preempted. *Cf.* 60 Fed. Reg. 11924, 11929 (1995) (notice of proposed interpretation that omits any description of "each" state law at issue).

since the very ambiguity that permits such deference proves that Congress had no clear and manifest intention to preempt non-conflicting state law.[17]

In sum, the OCC's unauthorized interpretation conflicts with Citibank's definition and is unreasonable. Petitioner's objective focus, in contrast, is supported both by the plain meaning of § 85 and the common law understanding of the phrase "interest at the rate." In the absence of any clear statements to the contrary, the presumption against preemption and the federalist design of the NBA require a narrow, plain English construction of "interest at the rate" in § 85.

CONCLUSION

For the reasons set forth above and in petitioner's opening brief, the judgment of the California Supreme Court should be reversed.

Dated: April 15, 1996

Respectfully submitted,

Patrick J. Grannan
Robin B. Howald
Chimicles, Jacobsen & Tikellis
633 West Fifth Street
Los Angeles, CA 90071
(213) 623-8100

Michael P. Malakoff
Malakoff, Doyle & Finberg, P.C.
The Frick Building, Suite 200
Pittsburgh, PA 15219
(412) 281-8400

Michael D. Donovan
(Counsel of Record)
Pamela P. Bond
Chimicles, Jacobsen & Tikellis
361 W. Lancaster Avenue
Haverford, PA 19041
(610) 642-8500

Counsel for Petitioner

[17] In any event, the OCC's recent interpretation cannot be given retroactive application to control the outcome of this litigation because Congress has not expressly granted to the OCC any authority to issue rules that bind retroactively. *See Bowen*, 488 U.S. at 208-09 (requiring an express grant of such authority).

REPLY APPENDIX A

61 Fed. Reg. 4858

Charging Interest at Rates Permitted Competing Institutions; Charging Interest to Corporate Borrowers (Section 7.4001)

Under 12 U.S.C. 85, a national bank may charge interest at the highest rate allowed to competing lenders by the state where the bank is located without regard to the location of the borrower. Thus, the statute permits a national bank to "export" to customers in other states the rate of "interest" allowed by the state in which the bank is located. The proposal defined the term "interest" in 12 U.S.C. 85 to reflect current case law. The proposed definition also reflected OCC interpretive opinions on the types of fees and charges that are included and not included in the meaning of the term. The proposal provided non-exclusive lists of specific fees that are "interest" (for example, numerical periodic rates, late fees, not sufficient funds (NSF) fees, overlimit fees, annual fees, cash advance fees, and membership fees) and that ordinarily are not "interest" (for example, appraisal fees, premiums and commissions on insurance guaranteeing repayment, finders' fees, fees for document preparation or notarization, or fees incurred to obtain credit reports).

Whether a particular fee or charge is properly characterized as "interest" subject to exportation has been the subject of litigation in a number of jurisdictions,[1] and the

[1] See, e.g., Smiley v. Citibank (South Dakota), N.A., 900 P.2d 690 (Cal. 1995), cert. granted, 64 U.S.L.W. 3500 (U.S. Jan. 19, 1996) (No. 95-860) (holding that the term "interest" as used in 12

OCC received many comments from parties on both sides of the issue. On one hand, certain consumer groups and attorneys representing class action suits opposed the proposal. These groups asserted that the proposed definition is contrary to the accepted meaning of the term "interest," and is contrary to consumers' interests. On the other hand, many national banks supported the proposal because it incorporates clear guidance on the OCC's position on the issue of what constitutes "interest" under 12 U.S.C. 85. The OCC believes that the Federal definition of "interest" and the components of interest in the proposal are both consistent with law and beneficial to national banks and their customers with respect to interstate lending operations.

The OCC also received comments from Arkansas trade associations and the Arkansas congressional delegation expressing concern that the proposed Federal definition of "interest" might be misinterpreted to require the inclusion of certain charges that are "interest" under the

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U.S.C. 85 encompasses late payment fees if such fees are allowed by a national bank's home state); see also Greenwood Trust Co. v. Massachusetts, 971 F.2d 818 (1st Cir. 1992), cert. denied, 113 S. Ct. 974 (1993) (holding that the term "interest" as used in section 521 of the Depository Institutions Deregulation and Monetary Control Act of 1980 (12 U.S.C. 1831d(a)), a statute modeled on 12 U.S.C. 85, includes late payment fees; in construing the term "interest" in 12 U.S.C. 1831d(a), the court concluded that these parallel sections should be read in pari materia). Contra Sherman v. Citibank (South Dakota), N.A., No. A-102-94, 1005 WL 710414 (N.J. Nov. 28, 1995), pet. for cert. filed, 64 U.S.L.W. 3439 (U.S. Dec. 21, 1995) (No. 95-991) (holding that the term "interest" as used in 12 U.S.C. 85 does not include late payment fees).

Federal definition, but not so under Arkansas law, when calculating the maximum effective yield permitted by Arkansas law. The commenters noted that, if the OCC adopts this interpretation, some loans now acceptable under Arkansas usury law could be found to be usurious. The OCC agrees that the language of the proposal is potentially confusing and might be interpreted mistakenly to affect the definition of "interest" in the Arkansas usury law (which, for example, permits banks to charge late fees, but does not include those fees as "interest" in calculating the maximum effective yield).

The definition of interest in Sec. 7.4001 is intended to define "interest" for purposes of determining if a particular charge is subject to 12 U.S.C. 85. Charges that fall within the Federal definition of "interest" are subject to 12 U.S.C. 85 and its "most favored lender" and exportation rules. The fact that a charge is not labeled "interest" under a particular state law does not necessarily mean that it is impermissible, however.

Section 7.4001(b) clarifies that, under the ruling (and 12 U.S.C. 85), one looks to state law to determine what lending charges are permitted for the most favored lender, and thus, also for national banks under 12 U.S.C. 85. However, the Federal definition of "interest" generally does not affect state law definitions of "interest" or the manner in which state law calculates the amount of interest being charged. For example, if late fees are not interest under state law where the national bank is located but state law allows late fees, then a national bank located in that state may charge late fees to its intrastate customers. The national bank could also charge the fees to its interstate customers because the fees are

"interest" under the Federal definition and an allowable charge under state law where the national bank is located. However, the late fees would not be treated as interest for purposes of evaluating compliance with state usury limitations because state law excludes late fees when calculating the maximum interest that lending institutions may charge under those limitations.

The final ruling addresses the concern raised by the Arkansas commenters regarding the effect of the Federal definition of interest on state law. The OCC has added to Sec. 7.4001 a new paragraph (c) that includes a clarifying sentence confirming that the Federal definition of the term interest does not change a state's definition of interest (nor how the state definition of interest is used) solely for purposes of state law. Paragraph (c) of Sec. 7.4001 also provides the example described in the immediately preceding paragraph of this preamble to illustrate this concept. The final ruling is substantially identical to the proposal, with the addition discussed above. In addition, the reference to "Morris Plan banks" that appeared in the last sentence of proposed Sec. 7.4001(b) has been removed as obsolete. Finally, paragraph (c), "Usury," in the proposal has been redesignated as paragraph (d) in the final ruling.

Most courts interpreting 12 U.S.C. 85 have concluded that various forms of non-percentage-based charges (including such items as late payment, overlimit, and annual fees) for the use of borrowed money fall within the scope of 12 U.S.C. 85. The final ruling is consistent with OCC interpretive letters in this area (see, e.g., OCC Interpretive Letter No. 670 (Feb. 17, 1995), reprinted in [1994-1995 Transfer Binder] Fed. Banking L. Rep. (CCH)

para. 83,618, and the letters cited therein) and reflects the position the OCC has taken in amicus curiae briefs in litigation pending in many state and Federal courts (see, e.g., OCC brief filed in the Supreme Court of Pennsylvania in Bank One, Columbus, N.A. v. Mazaika, Nos. 1995-31 and 1995-33 (July 17, 1995) (urging reversal of Mazaika v. Bank One, Columbus, N.A., 653 A.2d 648 (Pa. Super. Ct. 1994) (en banc), appeal granted, 659 A.2d 557 (Pa. 1995)).

Recently, the California Supreme Court upheld the ability of a national bank to charge certain fees as a component of "interest" and cited the OCC's recent interpretive opinions, as well as proposed Sec. 7.4001, as consistent with the court's reasoning. Smiley v. Citibank (South Dakota), N.A., 900 P.2d 690 (Cal. 1995), cert. granted, 64 U.S.L.W. 3500 (U.S. Jan. 19, 1996) (No. 95-860) (holding that the term "interest" as used in 12 U.S.C. 85 encompasses late payment fees, if such fees are allowed by a national bank's home state). See also Copeland v. MBNA America Bank, N.A., 907 P.2d 87 (Colo. 1995) (en banc), pet. for cert. filed, 64 U.S.L.W. 3469 (U.S. Dec. 28, 1995) (No. 95-1056); Richardson v. Citibank (South Dakota), N.A., No. 94SC670, 1995 Colo. LEXIS 767 (Colo. Dec. 18, 1995) (en banc); Spellman v. Meridian Bank (Delaware), Nos. 94-3203-3204, 94-3215-3218, 1995 U.S. App. LEXIS 37149 (3d Cir. Dec. 29, 1995).

However, the Supreme Court of New Jersey also issued a recent decision concluding that "interest" as used in 12 U.S.C. 85 does not include late payment fees. Sherman v. Citibank (South Dakota), N.A., No. A-102-94, 1005 WL 710414 (N.J. Nov. 28, 1995), pet. for cert. filed, 64

U.S.L.W. 3439 (U.S. Dec. 21, 1995) (No. 95-991). The decision of the New Jersey Supreme Court in Sherman conflicts with the decisions of the California Supreme Court in Smiley, the Colorado Supreme Court in Copeland and Richardson, and the U.S. Court of Appeals for the Third Circuit in Spellman, and the earlier decision of the First Circuit in Greenwood Trust. The U.S. Supreme Court recently granted certiorari in Smiley to resolve the conflict on an expedited basis.

As noted in the proposal, the ruling is not intended to be a comprehensive treatment of the issue, and other fees or charges may also be found to be components of interest.

REPLY APPENDIX B

[Other Letter Headings Omitted In Printing]

UNITED STATES SENATE

Committee on Small Business

Washington, DC 20510-6350
April 25, 1995

The Honorable Eugene Ludwig
Comptroller of the Currency
250 "E" Street, S.W.
Washington, D.C. 20219

Dear Mr. Ludwig:

We want to pass on to you the concerns of community bankers in Arkansas as well as our own thoughts regarding the proposed revisions of the OCC's interpretive rulings concerning calculation of interest rates.

According to news release NR 95-26, dated March 2, 1995, the Office of the Comptroller of the Currency intends to codify current OCC letters and individual case authority on types of charges included or not included in the term "interest" as used by law. While we understand the intention of the OCC's interpretation of Part 7 of 12 U.S.C. 85, the actual regulatory application may override a provision in the Arkansas State Constitution concerning usury.

The definition of "interest" has been litigated in the Arkansas courts for many years because of the state's strong policy against excessive interest rates. For 110 years the Arkansas Constitution prohibited lenders from charging any borrower more than ten percent (10%) interest. The penalty for violation of this rule was forfeiture of all principal and interest. The Constitution of 1874 was

amended in 1984 to provide a more modern approach by limiting the maximum rate of interest which can be charged by both state and national banks to the lesser of (i) five percent (5%) over the federal discount rate that is in effect at the time of the loan, or (ii) seventeen percent (17%).

Violation of this constitutional interest limitation also has severe repercussions, including repayment to the borrower of twice the amount of interest paid and forfeiture of future interest. In addition, violating the constitutional maximum places responsibility on the lender for the borrower's attorneys' fees.

Arkansas banks are extremely worried that loans now perfectly acceptable under Arkansas state usury laws could be found in a usurious position because of the OCC's definition of "interest". We ask that you carefully consider the legal ramifications for Arkansas bankers before issuing a federal regulation that overrides Arkansas state law.

Several bankers have written to us and to your office explaining these worries. Enclosed are a few copies for your information.

Thank you for your timely consideration of this matter.

Sincerely,

/s/ David
David Pryor

/s/ Dale
Dale Bumpers

[LOGO]
ARKANSAS COMMUNITY BANKERS

[Other Letter Headings Omitted In Printing]

April 3, 1995

Comptroller of the Currency
Administrator of National Banks
250 E Street, S.W.
Washington, D.C. 20219

Re: News Release 95-26

Dear Ms. Salus:

Arkansas Community Bankers Association represents 195 independent community banks in the State of Arkansas. The recently published News Release 95-26 regarding OCC proposals raises serious concern among bankers in Arkansas.

The Constitution of the State of Arkansas limits the maximum rate of interest which can be charged by both state and national banks to the lesser of: (i) five percent (5%) over the federal discount rate in effect at the time of the loan, or (ii) seventeen percent (17%). Violation of this constitutional interest limitation has severe repercussions, including repayment to the borrower of twice the amount of interest paid, and forfeiture of future interest. Additionally, violation of the constitutional maximum places responsibility on the lender for the borrower's attorneys' fees. Thus, all Arkansas banks, both state and federally chartered, diligently comply with the Constitutional provision.

The Comptroller of the Currency (OCC) has issued proposed revisions to its interpretive rulings (part 7 of its

regulations). Within the proposed provision, the OCC attempts to incorporate its private letter rulings and case authority from jurisdictions outside Arkansas concerning the types of charges which are or are not included as "interest". This proposed revision apparently attempts to utilize for national banks, to the maximum extent possible, the provisions of 12 U.S.C. § 85.

The implication of a regulatory definition of "interest," inclusive of charges which do not presently constitute "interest" under existing Arkansas law, is potentially damaging to all state and federally chartered banks in Arkansas.

The undersigned requests in OCC to reconsider its proposed revision to part 7 of its regulations, to provide that the proposed revisions apply only when a national bank is attempting to export its home state usury laws for loans to out-of-state borrowers, i.e., limit the proposed revision to part 7 as an interpretation by the OCC of 12 U.S.C. § 85. In the alternative, the OCC could make the proposed provisions optional, at the election of each institution.

The undersigned vigorously urges the OCC to consider the implications of a regulatory definition of "interest" upon banks located in states with constitutional interest limitations, such as Arkansas. Otherwise, Arkansas banks will face the dilemma of "dual accounting" systems wherein one calculation of "interest" is done pursuant to OCC regulation, with a second calculation maintained for protection under the Arkansas usury law. If the proposed OCC definition of "interest" is adopted, any calculation of interest made thereunder will be discoverable and

admissible in court to convince a trier of fact that a loan, presently acceptable under Arkansas usury law, is usurious because of the regulatory definition of "interest."

Thank you for your consideration in this matter. Please call me with any questions.

Sincerely,

/s/ Pete Maris
Pete Maris
President
Arkansas Community Bankers
Chairman
Bank of Little Rock

PM/rt

cc: Arkansas Washington Delegation